

THE BUDGET, AN INSTRUMENT FOR PLANNING AND CONTROLLING THE COSTS

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The budget is a management instrument used by any entity, financially ensuring the dimension of the objectives, revenues, expenses and results at the management centers level and finally evaluating the economic efficiency through comparing the results with those budgeted for.

A major component of the managerial control, the effectiveness of the budgeting process is reflected in the fact that: requires the strategic planning and implementing the plans, offers a frame of reference for performance evaluation, contributes to personnel motivation, encourages the coordination and communication.

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The Budget and Budgetary Cycle Concepts

All throughout the activity, regardless of how perfect the unit's strategy is, controlling the predictions is necessary to track down the causes that lead to certain deviations, to assign responsibilities and to anticipate some corrective measures for them. This prediction control system that contributes to achieving the time-targeted objectives, of one year deadline usually, is called *budgeting*.

Budgeting represents the accounting instrument used by companies on a regular basis to plan and control their actions in order to satisfy their clients and secure their success on the market⁶³⁷.

The budget can be defined as a „financial plan that includes calculating the revenues and expenses of the state, a social or economic organization for a determined period of time”⁶³⁸.

The budget is the quantitative expression of the plan framed by the administration for a specified period and a support for the coordination of the necessary activities in implementing that plan. A budget may reflect both financial and non-financial issues concerning the plan and represents a „schedule” regarding the forthcoming period. A budget that includes financial aspects quantifies the administration's predictions regarding the profit, treasury's cash flows and financial statement of the entity. The financial statements for the forthcoming period can be drawn up the same way as those for the former periods. Non-financial budgets can be drawn up in addition to these financial budgets such as those regarding the number of products, the number of employees or the number of new products introduced on the market.

The budget may become an instrument for the amortization and optimization of the relation between revenues and expenses within an entity whereas the costs budgeting may become a systematic economical practice that demands carrying out a formal process by which financial resources are distributed in order to achieve the time-objectives for the forthcoming periods⁶³⁹.

⁶³⁷ Charles T Horngren, Srikant M. Datar, George Foster, *Costs accounting, a managerial perspective*, Arc Publishing, Craiova, 2006, p. 198;

⁶³⁸ Gheorghe D. Bistriceanu *Finances, banks and insurances thesaurus, Vol. I*, Economica Publishing, Bucharest, 2001, p. 234

⁶³⁹ Sorin Briciu, *Managerial accounting, theoretical and practical issues*, Economica Publishing, Bucharest, 2006, p. 248.

Practically, the budget can be viewed as a list, a document that includes the predictable revenues and expenses of an entity, regardless of its size, within a certain period of time. The budget represents the underlying activity of the economical agents.

The budget reflects the economical unit's revenues and expenses, financial results, proper funds including the employees' contribution to the profit, bank loans and their reimbursement, payments to the treasury and information regarding the main indicators of its activity.

The budget contributes to maintaining a permanent balance between receivables and payments and also ensures a continuous capacity of payment. The budget of an enterprise reflects the potential of achieving its revenues, the expenses' limit as well as its final results. The unit's financial balance must permanently reflect the match between the monetary resources and the actual needs, according to the requirements of a lucrative economical-financial activity.

In the context of economic competition, where the companies' activity must be lucrative, the budget contributes in increasing the profit and decreasing expenses, therefore the budget represents a leading instrument. The budget is an instrument used by any entity, financially ensuring the dimension of the objectives, revenues, expenses and results at the management level and finally evaluating the economic efficiency through comparing the results with those budgeted for.

The elaboration, monitoring and controlling the budgets is mandatory for the purpose of acknowledging the results and delivering private information necessary for the decision making. If the budget is designed to present all the predictable figures of the enterprise, it is questioned whether autonomous subsystems called expenses centers (places) aimed at optimizing the use of resources and making profit should be created within. The expenses center is a recognizable function or a part of the enterprise for which the expenses can be identified. In the case of the profit center, both the expenses and revenues can be identified.

The budget center represents a sector of an entity that can be controlled and budgeted. A budget center may be an expenses centre, an assembly of expenses centers or may coincide with a profit center. Depending on its size, a common profit center may consist of several budget centers which may independently consist of either a single expenses center or an assembly of interconnected expenses centers.

The budgeting process is characterized by the following features:

a) Planning and coordination

The budgeting process is based on some more general long-term objectives with the purpose of elaborating thorough operational plans for different sectors or executive links of the enterprise. Planning is the key to success in any business and it is encouraged by the allotment of budgetary resources.

Planning is reflected in the *master budget* that includes all the *secondary budgets*, a fact that determines the managers to consider the relation among the function of the budgets and the various departments of the enterprise and to analyze the way in which they contribute to achieving the objectives.

b) Authority and responsibility

The budgeting process assumes that the entity is organized in responsibility or budgetary centers and follows clear instructions regarding the responsibilities of each manager that has a budget as well. Adopting a budget includes the authorization of all its activity plans, allowing the exceptional management which means that a subordinate is given a specified role and also the authority and necessary resources to carry out the assigned part of the plan but if the activities do not follow the plan, the variations are reported to the superior authority.

c) Communication

The budgeting process involves all the managerial levels and constitutes an important means of communication between the superior and middle management regarding the targeted objectives and their achievement. When the budgeting process ends, the approved plans are communicated to the entire involved personnel.

d) Control

This element of budgeting is the least expected by employees. The process of comparing the current results with the planned or budgeted results and reporting the comparison's results, which is in fact the budgetary control, establishes a guideline for carrying out the plans within the set limits for the expenses.

e) Performance evaluation

The performance of the managers is partially evaluated according to their ability to implement the budgets. The data regarding the manager's budget and his ability to achieve the budget objectives is an important factor whenever a manager is evaluated to be promoted, to be given a raise or in any other kind of assessment. The budgets used as objectives may assist a manager in monitoring his own performance.

The budget objectives are:

- provide the basic information, the cost for elaborating the development plans;
- indicate the conditions under which the patrimonial unit must work to achieve the targeted objectives (e.g. the amount of sales that ensure the predicted profit until the end of the trimester);
- represents an instrument for coordinating the activity within the patrimonial unit encouraging the information circuit regarding the costs and increases the awareness among the individuals responsible for the expenses centers;
- increases the capacity to anticipate the consequences of the decision made or that are about to be made, since the budgets are a referential image directed by the decision makers.

The budgeting procedure can be divided into the following stages:

1. Setting of the company's objectives for the following year (operational plan) by the general administration and communicating them together with the information regarding the business environment to the management centers;
2. Elaboration of the provisional budgets (prebudgets) by each individual responsible for the designated centers within the enterprise and the selection of one desirable version;
3. The assessment of budgetary coherence according to which the provisional budgets of each responsibility center are regrouped at the level of general administration so that the coherence among the different components of the budget is evaluated. The management centers and the budget committee organize a debate on the objectives and resources allotted for their achievement, negotiating the objectives and assigned resources for each budget. The management controller has a very important role in this stage because he analyzes the credibility of the initial hypothesis and objectives, evaluates the sensitivity of the results in relation with the most uncertain variables and ensures the existence of a reserve fund at the level of general administration that can be used throughout budgets' execution in the case of an unfavorable turn of events or an unexpected management situation at the level of budgeted entities.
4. The elaboration of definitive budgets and their delivery to the responsibility centers;
5. Monitoring the budgets' execution and their update depending on the evolution of the business environment and the achievement of the objectives;

The advantages of the budgeting process are:

- the manager of the patrimonial unit has the possibility of coordinating all of its functions (supply, production, sale);
- indicates the conditions under which the patrimonial unit can achieve the targeted objectives;
- provide the necessary information for setting up future actions;
- allows the comparison of the targeted objectives with the performance of the patrimonial unit;
- allows the anticipation of certain difficulties that might be met and the solutions for their prompt counteraction.

The disadvantages of the budgeting process are:

- the risk of having the patrimonial unit's activity blocked on one single plan of action;
- the aversive reaction of the employees in the case of unrealistic objectives;

- the risk of losing control over the costs due to the misconceptions of the employees and chiefs of departments according to which smaller resources will be allotted for the next year if during the current year a smaller amount of resources than allotted are used.

Another important issue regarding budgets is the *budgetary management*. The budgetary management or the budgetary system represents the management process consisting of translating the numerical action plans called budgets, the decisions made by the administration with the participation of the responsible agents. The budgetary management includes preparing the budgets, analyzing the errors and correcting them.

The budgetary management is based on the following principles:

- *the integrity principle*, which entails that all the activities of a patrimonial unit should be characterized by a perfect coordination between the various functional and operational services;
- *the principle of superposition* of the budgetary system over the authority system from the patrimonial unit, which means that the budget must be identified with a responsible individual and its accounting authority description;
- *the principle of maintaining the solidarity among departments and the congruence with the strategic objectives of the patrimonial unit*;
- *the versatility principle*, which means adjusting the budgets to the changes in the economical variables;
- *the principle of personnel policy coupling* to determine the motivation and adhesion of the personnel to the targeted strategic objectives;
- the principle of updating the budgetary predictions.

The budgetary management has the following characteristics:

- is a result of the strategy and predictions;
- is an element of coordination among several levels of activity, since the budgets are inter-correlated;
- has some limitations such as being too theoretical, expensive and sometimes unusable.

The effectiveness of the budgetary management depends on the quality of predictions but also on the corrective measures taken.

The elaboration of an organization's budget is important to its success for three reasons. First of all, the elaboration of the budget requires the management to analyze the future activity and plan the objectives and events in the short run as well as in the long run. Second, the entire managerial team must collaborate in the setting and following these plans. Third, performance analysis on each managerial level is possible by comparing the budgets with the actual results.

The budgetary system of an entity is one of the most practical management control procedures, precisely organizing the tasks for enhancing the enterprise's performance and correcting the potential errors. It indicates the way in which profit is obtained, allowing the decision makers to understand the factors that generate profit and to operate upon the controllable variables that influence the achievement of foreground objectives. Moreover, the budgetary system directly contributes to the elaboration of provisional synthesis documents: provisional balance sheet, provisional income accounts, treasury and financing plans.

In order to achieve its objectives, the budgetary system must meet the following conditions:

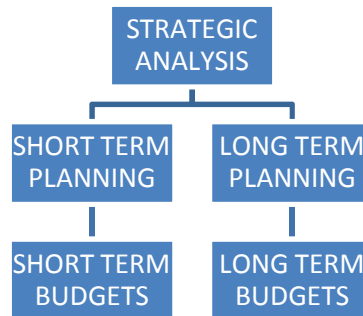
- implication and support from the top management;
- implication of all department managers in throughout all aspects of the budgeting procedure;
- clearly defining the long-term objectives;
- a realistic organizational structure, with clearly defined responsibilities;
- the accounting and informational system must be adequate;
- the regular revision of the budgets and the objectives;
- the administration of the budgets in the most flexible way⁶⁴⁰.

⁶⁴⁰ Briciu Sorin, *The Informational System regarding the management accounting and calculation of costs in industry*, Argus Publishing, Bucharest, 2000, p. 47.

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1. Strategic planning and implementing the plans

Budgeting is effective if it is a part of a company's strategic analysis, which means that the long term planning is used in the elaboration of long term budgets whereas the short term planning is used in the elaboration of short term budgets.



2. The budget, a frame of reference for performance evaluation

A company's performance can be evaluated through its reference to the elaborated budgets for those plans, which contributes to the elimination of some difficulties concerning the use of past results in analyzing the current results such as:

- the past results include the activity's failures, the substandard performance within the previous period;
- the activity's conditions can differ in the future as compared to those in the past.

The evaluation of individual professional performance represents the set of processes and procedures implemented annually through the application of performance criteria for the degree of accomplishing the professional objectives based on the job description.

The individual objectives must meet the following requirements:

- the activities must be specific and in accordance to the requirements listed in the job description
- to be measurable, and have a concrete form of achievement;
- include deadlines;
- set realistic expectations that can be accomplished within the specified deadlines and with the allotted resources;
- are flexible in the sense that they can be revised depending on the encountered modifications and priorities.

The evaluation of individual professional performance is based on special legal regulations for each personnel group, requiring the different approach of these issues.

The score for achieving the objectives is obtained by calculating the arithmetic average of the grades given for the achievement of each objective, including the individual revised objectives in the case a revision was necessary during the evaluation period. The score for achieving the performance criteria is obtained by calculating the arithmetic average of the grades given for achieving each criterion. The final score of the annual evaluation is obtained by calculating the arithmetic average of the individual objectives and performance criteria grades.

The evaluation procedure consists of three stages as follows:

- drafting the evaluation report by the evaluator;

- the interview;
- registering the evaluation report.

3. *The budget, a motivational factor for achieving the objectives*

Research studies report that “bold” budgets contribute to improved results since the incapacity to accomplish the predicted levels budgeted for is perceived as a failure. The majority of the employees is motivated by the desire to avoid failure and succeed; as soon as they get closer to achieving an objective, they intensify their efforts to attain it. For these reasons, setting high but achievable objective is important.

Training is a difficult task of the management, entailing decisions that determine the personnel to participate in the process of targeting and achieving the objectives, taking into consideration the motivational factors.

Therefore, I estimate that the chief of departments should try to get to know each subordinate’s personality and more importantly their professional interests and their predispositions with regard to a certain working activity.

From the point of view of the instrumentality of personnel motivation, the manager of each organizational link may intervene in the following ways:

- through positive motivational factors, offering the subordinate employees the possibility to attain their professional goals, to publicly recognize their achievements, to facilitate their promotion, to facilitate their personal development;
- through diminishing the effects of negative motivational factors (hygiene factors), the supervision strategies, promoting interpersonal relations, ensuring an adequate working environment, organizational culture.

4. *The budget, an instrument for promoting the coordination and communication among the institutional structures*

Coordination represents the deployment and trimming of all production or service factors from all economical functions and departments in the most effective way to allow the company to achieve its objectives.⁶⁴¹

Communication assumes that the personnel from all organizational subunits understands and accepts these objectives.

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⁶⁴¹ Charles T. Horngren, Srikant M. Datar, George Foster, *Costs accounting, a managerial perspective*, Arc Publishing, Craiova, 2006, p. 201